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24 SEP 1980

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MEMORANDUM FOR: Deputy Director of Central Intelligence
FROM : Harry E. Fitzwater
Director of Personnel Policy,
Planning, and Management
SUBJECT : Merit Pay System

1. Action Requested: It is requested that you approve the recommendation contained in paragraph 4.

2. Background:

a. The Civil Service Reform Act of 1978 provides for the establishment of a Merit Pay System for GS-13, 14, and 15 supervisors and managers in order to recognize and reward quality performance. The system is closely linked to performance appraisal. Funding is provided by merit pay pools equal to regular and quality step increases and 50 percent of comparability pay increases and by a budgeted cash award program. Covered agencies are required to put their implementation plans into effect no later than 1 October 1981.

b. CIA is exempt from the merit pay portion of the Act. At the time that the Agency established the Senior Intelligence Service, it was decided that a study would be undertaken on the Merit Pay System toward determining whether the Agency should adopt such a system. The study by the Office of Personnel Policy, Planning, and Management has been completed and is highlighted below. A meeting of the Personnel Management Advisory Board was held to review and discuss this study and the Board concurred in the study's conclusion and recommendation. Copies of the study and the minutes from the Personnel Management Advisory Board meeting are attached.

3. Staff Position:

a. Merit Pay Considerations for CIA

(1). Factors

The Director of Central Intelligence has the authority to institute a Merit Pay System for CIA. There are several factors that need to be considered in determining whether or not CIA should have a Merit Pay System. All of the factors listed are not proven -

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some are projected, and each factor is not necessarily totally positive or totally negative.

a. Positive

- The purpose of a Merit Pay System as envisioned under the Civil Service Reform Act is theoretically sound; i.e., "to provide a Merit Pay System for supervisors and management officials in grades GS-13, 14, and 15 positions which will recognize and reward quality performance by varying merit pay adjustments."
- The funds expended by the Agency for comparability pay, periodic step, and quality step increases might be better utilized under a Merit Pay System in recognizing and rewarding high quality performance; i.e., quality performer will be paid more than a lesser performer at the same grade level. The cash award program gives supervisors of merit pay employees an additional compensation tool as well as greater flexibility in granting appropriate recognition for employee performance, and the present cash award program in CIA would be significantly expanded both in monetary amount and activity under a Merit Pay System.
- Training in merit pay and performance appraisal could benefit CIA through improved performance of supervisors in the areas of developing performance standards, observing performance, and performance appraisal and ratings.
- If significant improvements in performance and productivity could be definitely assured, the long-term benefit to be gained through a Merit Pay System might override the costs in efforts and resources in developing such a system for the Agency.

b. Negative

- Although there is a positive impression from looking at the purpose of merit pay, there are serious doubts in the minds of Federal managers and employees that a Merit Pay System can actually be made to work effectively, doubts which will not be confirmed or denied until well after October 1981 when all covered agencies must begin their programs.

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- Covered employees would be denied 50 percent of their comparability pay increases, as funds from this and periodic and quality step increases make up the merit pay pool. Covered employees in other agencies have expressed strong concerns about being denied 50 percent of their comparability pay increases.
- Even in private industry, which has had a relatively long experience with Merit Pay Systems, there are reservations about the real worth of incentive pay, particularly as regards morale problems created among covered employees and their supervisors.
- Should merit pay in the Agency have a negative morale or performance impact, the impact would be extensive as a substantial number of Agency employees would be involved as covered employees and their supervisors. There is no way to determine the nature and extent of this factor without monitoring the implementation of merit pay in other Federal agencies.
- The current CIA Performance Appraisal System is not yet at a stage where supervisors can set standards and appraise employees with sufficient precision and accuracy to meaningfully support a Merit Pay System. Experience gained from the SIS awards procedure may provide the basis to begin modifying the Performance Appraisal System accordingly.
- There may be better ways for the Agency to utilize funds for comparability pay, periodic step increases, quality step increases, and cash awards than a Merit Pay System in the CSRA mode to stimulate and recognize quality performance.
- It would be necessary to dedicate considerable resources, regardless of the soundness of the concept, should the Agency adopt merit pay. Analysis of positions to determine employee coverage by supervisor/managerial definitions would require extensive time and personnel resources. Supporting mechanisms for calculating and allocating merit pay funds and for linking performance appraisals to merit pay are complex and would require substantial time, personnel,

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and money to design, implement, and operate. Extensive, timely, and continuous ADP support throughout the planning and implementation of a Merit Pay System would be required.

b. Conclusions:

- A few agencies will put their systems into effect in October 1980, but the vast majority will wait until October 1981. Although the designs of the various systems can be analyzed in the meantime, it will be well into 1982 before it is known if the systems are working effectively, i.e., accomplishing the purpose of merit pay. By that time, the various agencies will be perceiving positive and negative aspects of their own and other systems and beginning to work toward adjusting each of their own systems accordingly.
- It is quite apparent that anticipation of the implementation of merit pay is causing considerable anxiety among large numbers of covered employees throughout the government. Immediate adoption by the Agency of a system with unproven results might well produce similar effects on Agency employees.
- In implementing a Merit Pay System in the near future, the Agency would risk making mistakes that might not be made if we monitored various systems of other agencies and benefited from their experiences. CIA has the opportunity to determine whether a CSRA type Merit Pay System is indeed of positive worth and, if so, to determine the more suitable approaches in designing and implementing a system with less resources costs.

4. Recommendation:

It is recommended that the Agency not adopt merit pay at this time, but that the Office of Personnel Policy, Planning, and Management monitor Merit Pay Systems in other government agencies, preparing periodic reports, in order for Agency management to have a basis upon which to reconsider later whether CIA should have a Merit Pay System.

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Attachments

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Deputy Director of Central Intelligence

Date

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